

Statement of Robert M. Couch

**President & CEO
New South Federal Savings Bank
Birmingham, AL**

on behalf of

Mortgage Bankers Association

before the

Financial Services Housing and Financial Institutions Subcommittees

U.S. House of Representatives

Hearing on

"Preventing Abusive Lending While Preserving Access to Credit."

November 5, 2003

Good morning Mr. Chairman and members of the Committee. My name is Rob Couch, and I am President and CEO of New South Federal Savings Bank, in Birmingham, Alabama. Today, I appear before you as Chairman of the Mortgage Bankers Association (MBA).¹

I commend the Committee's leadership in calling for hearings on the vital matter of consumer abuse in mortgage lending, and want to thank you for inviting MBA to participate in the very important undertaking of exploring the methods by which we can stem so-called "predatory lending." As Chairman of the trade association that represents the real estate finance industry, and as President of an institution that is primarily engaged in mortgage lending, I am personally very disturbed by any reports of consumer abuse in our industry.

At the outset, I want to declare that MBA condemns abusive and so-called "predatory lending" practices in the strongest possible terms. We want this committee to know that this association has been an active and dependable partner in the continuous search for solutions to this problem. Although it is quite difficult to accurately measure and quantify abusive mortgage lending activity, MBA does not shy away from the fact that certain rogue lenders and unscrupulous brokers have preyed upon our most vulnerable citizens. MBA accepts the need to act in the face of these continuing abuses.

We warn, however, that as we search for solutions and better protections for American homeowners, we also have the duty and obligation of ensuring that we do not act in a way that constricts the flow of capital to credit-starved communities. Our industry has

¹ MBA is the premier trade association representing the real estate finance industry. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership prospects through increased affordability, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate professionals through a wide range of educational programs and technical publications. Its membership of approximately 2,700 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies and others in the mortgage lending field.

been extremely successful in expanding access to mortgage capital to all segments of our population, and we cannot afford to reverse on these hard-earned advances.

I. Overview of MBA Position on Predatory Lending

Let's set the record straight—"predatory" mortgage lending is not a new problem; in fact, it is only the current manifestation of what we have traditionally referred to as "mortgage fraud." In the end, the tactics used by unscrupulous actors in "predatory lending" schemes are aimed at deceiving consumers, hiding the true costs of the transaction, and blinding unsuspecting and unsophisticated homeowners from the full marketplace of competitive products and services.

MBA believes that "predatory lending" has three fundamental root sources that need to be jointly attacked. These are (1) the complexity of the laws and mandated disclosures, (2) the lack of consumer education, and (3) the lack of adequate enforcement of existing laws. Any attempt to achieve long-lasting solutions in this area must, necessarily, isolate these specific causes and address them through carefully tailored approaches.

Complexity of Mortgage Laws

First and foremost, we believe that a root problem leading to abusive lending is the confusion created by the complexity of the laws and disclosures that apply to the mortgage process. Mortgage-related disclosures are voluminous and often cryptic. Consumers rarely use these forms and disclosures to compare prices or identify the terms of the transaction because, quite simply, they cannot understand what they read nor what they sign. In addition, the mandated forms lack reliable cost figures, a fact that impedes prospective borrowers from ascertaining true total costs.²

² There are various confirmations of this core problem. In a 1998 report prepared by the Federal Reserve Board and the U.S. Department of Housing and Urban Development, these federal agencies ascertained that most consumers do not understand the relation between the contract interest rate and the Annual Percentage Rate ("APR") listed in the Truth in Lending disclosures. The agencies explain that "the [consumers'] belief was based on misconceptions about what the disclosures represent. For example, consumers believed the APR represents the interest rate... and the amount financed represents the note amount... ." These are fundamental misunderstandings that can lead to very serious repercussions for unwary or unsophisticated shoppers. In fact, there are reports that these cryptic forms, and the public's misunderstanding of them, make the federally-required Truth in Lending disclosures a very useful tool for predators to confuse and defraud consumers.

More urgently, however, we note that the complexity of the current system serves as the camouflage that allows unscrupulous operators to hide altered terms and conceal crucial information without fear of the consumer discovering or even understanding the import of the masked or undisclosed items. In light of this complexity, confounded borrowers stop shopping and turn to loan officers for advice. In instances of abusive originators, the consumer's total reliance on a third party closes the loop of deception—the victims of these scams are completely blinded to the realities and repercussions of the transaction. These problems are exacerbated in instances of uneducated, illiterate, or non-English-speaking consumers.

Lack of Consumer Awareness/Education

The complexity of the mortgage process leads directly to, and is intertwined with, the second source of predatory lending—lack of consumer awareness and education. It is a reality today that even well-educated consumers tend to lack basic understanding of the mortgage shopping and home buying processes. We know, for example, that most consumers understand neither the meaning nor importance of the “Annual Percentage Rate” figure. Nor do mortgage shoppers entirely comprehend that the early Good Faith Estimate disclosures are not “guaranteed” or final. These misunderstandings have very real repercussions regarding the choices that consumers make and the products that they ultimately select. Misperceptions regarding these disclosures, or failure to understand their content, create an environment that is ripe for the manipulation and exploitation of consumers by devious and unscrupulous operators.

Lack of Enforcement

A third problem creating a favorable environment for abusive lending is the general absence of real enforcement of the multitude of loans that apply to this area. It is important to understand that mortgage lending is one of the most heavily regulated industries today. Mortgage lending is subject to pervasive state regulation and lenders must comply with a wide array of federal consumer protection laws including the Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Housing Act, Fair Credit

Reporting Act, Equal Credit Opportunity Act, Fair Credit Billing Act, Home Mortgage Disclosure Act, Federal Trade Commission Act, and Fair Debt Collection Practices Act. Many of the “predatory” abuses reported today either violate current law or result from lack of disclosures that violate current laws. As noted earlier, in practically all instances of abuse, the “predatory” lender uses these and other disclosures in a way that involves outright fraud and deception.

In addition, states generally have laws that can be used to effectively combat abusive mortgage lending practices. These include: prohibitions against unfair and deceptive trade practices; prohibitions against discrimination and redlining in finance transactions; limitations on specific terms of consumer and mortgage credit; limitations on insurance products; penalty provisions for non-compliance; prohibitions of deception misrepresentation; non-disclosure and concealment; and common law rules against fraud.

In summary, MBA believes that any approach that does not address these three basic prongs—simplification, education, and enforcement—will merely deal with the effects and not with the underlying causes of the problem.

II. Importance of National Mortgage Markets

Before identifying methods to address the root causes of “predatory lending,” it is extremely important to understand the structure of today’s vibrant mortgage market. It is crucial to recognize that the vast majority of mortgage loans are no longer made from bank reserves or monies derived from depository sources; rather, mortgage loan capital is largely obtained from securitization and the sale of mortgage-backed assets to secondary market investors.³ In the modern mortgage market, most of the capital used by lenders to fund mortgages is derived from national and international capital sources that include Fannie Mae, Freddie Mac, Ginnie Mae, Federal Home Loan Banks, and a

³ Our estimates reveal that, in 2002, over 75% of all U.S. residential mortgage production was securitized and sold into the secondary market.

wide array of private investor sources. Mortgage lending is therefore conducted on a truly national scope. These national sources for mortgage capital have served to achieve great cost savings for consumers through added efficiencies and considerable economies of scale. These secondary market entities have produced a uniform national mortgage market by enabling transfers of capital and excess savings from money-rich areas to money-poor areas.

This truly amazing mortgage structure, based upon an international secondary market, has given the American population the best, cheapest, and most efficient mortgage capital delivery system in the world. This highly functional secondary mortgage market is, however, greatly dependent on legal certainty and predictability. In short, secondary market investors must have the security of being able to purchase and trade mortgage-backed assets without undue complications and without excessive legal risk. In this sense, only standardized lending rules will provide capital markets with the foundation of necessary legal uniformity that ensures enforceability of particular transactions while facilitating securitization and the flow of capital.

III. “Subprime” Lending

This mortgage system has been especially important with regard to the so-called “subprime” market sector. This sector of the market focuses on portions of the population composed of consumers that, for various reasons, have less than stellar credit records or other flaws. These consumers can very often still be considered viable credit candidates, often with the assistance of financing options that serve to mitigate credit risks. It is important to realize that until a few years ago, this segment of the population did not have the option of obtaining mortgage financing from traditional lending institutions, as creditors would only risk lending large sums of money for long terms to those individuals that possessed faultless credit scores. However, through innovations in the mortgage finance industry, and through various financing and risk enhancing tools created for the specific purpose of extending credit to our more needy

communities, credit-impaired individuals now have ample opportunity to obtain loans through this “non-prime,” or “subprime” market.

This segment of the industry has become an increasingly important, and very essential, piece of mortgage lending. As the U.S. Department of Treasury and the Department of Housing and Urban Development acknowledge in a recent report, “[b]y providing loans to borrowers who do not meet the credit standards for borrowers in the prime market, subprime lending provides an important service, enabling such borrowers to buy new homes, improve their homes, or access the equity in their homes for other purposes.”⁴ Although subprime originations comprise approximately 9% of all mortgage originations, over the past few years, we have seen tremendous growth in subprime lending. According to Federal Reserve Board estimates, subprime mortgage originations grew seven-fold over the 1994-2002 period. This growth has disproportionately benefited low-income and minority borrowers, as these groups are much more likely to rely on subprime credit. One clear and visible outcome of this expanded subprime lending activity has been an increase in homeownership rates for low-income and minority borrowers. According to Federal Reserve Governor Gramlich, “this represents a welcome extension of home mortgage and other credit to previously underserved groups—a true democratization of credit markets.”⁵ MBA agrees. We note that millions of low- and moderate-income families now have a chance at owning a home and building wealth due specifically to the rapid growth of subprime credit.

IV. Proliferation of State and Local Predatory Lending Laws

The products that are allowing for this incredible and unprecedented expansion of credit access to needy communities are, however, coming under increasing threat. As has been widely reported, there is currently an unprecedented level of legislative activity aimed at passing so-called “anti-predatory” measures at state and local levels.

⁴ United States Department of Treasury and Department of Housing and Urban Development, *Curbing Predatory Home Mortgage Lending: A Joint Report*, June 2000 (“HUD/Treasury Report”).

⁵ Remarks by Governor Edward M. Gramlich at the Texas Association of Bank Counsel, 27th Annual Convention, South Padre Island, Texas (October 9, 2003).

Although well-intentioned, these state and local laws are posing restrictions that hamper lending operations in the subprime market while creating a “balkanized” legal system that threatens secondary market operations and damages our industry’s ability to deliver mortgage capital to underserved communities.

Effects

The harmful effects of state-level legislation are multi-faceted. As a threshold item, we observe that none of these state-based laws sets forth a uniform or workable definition for “predatory lending,” or what constitutes “abuse” in the context of mortgage lending. Indeed, the terms “predatory lending” and “subprime lending” are often and repeatedly used interchangeably. In public debates, official reports, and media coverage surrounding this highly politicized issue, it is often openly asserted, for example, that higher-than-normal interest rates or the presence of certain terms, such as balloon provisions, are inherently predatory. Sometimes, a minor regulatory deviation will be referred to as a “predatory scheme.” These fallacies continue to poison the discourse on this very important subject and make clear that there is no consensus on a premise from which to advance.

A further element of “predatory lending” legislation at state and local levels is that it focuses on enacting increasingly burdensome restrictions and outright prohibitions on specific loan terms, such as prepayment fees and late charges. These loan terms have legitimate uses; they enhance a lender’s ability to structure credit for consumers with special needs and exceptional circumstances—credit impairments, irregular income streams, etc.—and to allow them to be able to access the equity in their homes. By imposing restrictions and prohibitions against useful financing tools that are misused by a few unethical actors, state laws are damaging the entire home equity market.⁶

⁶ See, e.g., New York’s prohibition of “balloon notes” in covered loans (*General Regulations of the Banking Board, Part 41 (“Restrictions and Limitations on High Cost Home Loans”)*); New Jersey’s complex restrictions on “prepayment penalties” in covered loans (*New Jersey Home Ownership Security Act of 2002* (Assembly Bill No. 75)).

Diminution of Credit

MBA believes that all these negative effects give rise to truly disastrous outcomes. In their zeal to protect vulnerable consumers, state legislators and consumer groups are creating a hostile legal regime that is causing lender flight and diminishing capital access for the most needy segments of our communities. The subprime market, by definition, depends on the ability of creditors to effectively control for the borrowers' credit risks; by eliminating risk-abating financing tools, state legislators and consumer groups are crippling lenders' ability to ensure the proper delivery of subprime capital.

Moreover, these very confusing state and local laws that purport to protect consumers are imposing a veritable maze of "triggers," disclosures, and prohibitions on covered mortgage loan products. The proliferation of these laws creates massively complex compliance labyrinths that are entirely unwieldy. Multi-state lenders today find it extremely difficult, if not impossible, to formulate models for compliance in any one geographic location without the high probability of falling out of compliance in a different locality. In fact, the unending passage of these "predatory lending" laws at state and local levels is creating a situation where multi-state lenders are finding it almost impossible to comply, or even keep up with, with the full barrage of local rules and regulations that are continually enacted.

Equally critical is the very negative impact of these state legislative developments in terms of the secondary market. We note that secondary market investors follow strict compliance and quality assurance requirements to ensure that the assets they purchase are comprised of loans that meet the requirements of state and federal law. The fragmentation of legal requirements caused by differing state legislation imposes crippling confusion for purposes of purchasing and enforcing mortgage loans since every individual portfolio in a given national pool of loans could carry differing legal requirements based on the particular state where the loan was originated. In such an environment, secondary market operations are in disarray, as complex questions of compliance and enforceability drown efficient flows of mortgage capital. In the current "balkanized" environment, secondary market players are now required to undertake

extensive, and extremely costly, due diligence analyses, reach detailed conclusions relating to specific loan originations as part of expanded due diligence processes, and implement costly operating systems to comply with varying and ever-changing laws.

If that were not enough, these difficulties are now being exacerbated by recent enactments of state legislation that impose unlimited purchaser or assignee liability for the practices of an originator, broker, or even servicer. This trend has begun to draw a strong negative reaction by all segments of the secondary market community. In the past several months, rating agencies such as Fitch and Standard & Poors have refused to rate assets that contain loans originated in jurisdictions that impose liability on assignees. This trend is dangerous, as the agencies' refusal to rate assets is extremely alarming to investors, and will invariably dry up secondary market investment. It is likely that the agencies' refusal to rate covered assets will severely restrict funding for all loans covered by these laws.

In the end, we note that the clear impact of this burdensome, confused, and fragmented regulatory framework at the state and local level is lender and investor flight from the states and municipalities covered by these laws. The experience in the State of Georgia is very illustrative. In 2002, that state enacted the Georgia Fair Lending Act ("GFLA") to stop unscrupulous lending activity in mortgage lending. That law was so broad in its application, and contained so many undefined terms, ambiguities and misclassifications, that even traditional lenders exited the market. The secondary market reacted very negatively, in chorus with decisions by the rating agencies to refrain from rating any securities containing loans covered by the GFLA. In due course, Georgia's state legislators returned to amend the law in order to halt the flight of mortgage capital from the state. This legislative experiment, though well-intentioned, cost the industry millions of dollars in compliance and legal fees, and proves that this

type of state legislative activity has direct and dramatic effects on lenders' willingness to do business in particular markets.⁷

It should be noted that lender and investor flight will not only decrease capital availability in affected markets, but will, with all certainty, raise the costs of the remaining sources of mortgage capital. If legitimate institutional players leave this market segment, the price of capital in those markets will skyrocket as supply is diminished relative to demand. If history is a lesson, supplies of capital could decrease to the point of pushing cash-strapped consumers to non-traditional, and indeed very costly and even dubious, money sources.

In summary, the growing number of state and local "predatory lending" laws hurt precisely those populations that they are meant to benefit.

V. Steps to Address Abusive Lending

As we search for solutions, we believe that mortgage industry participants, policymakers, and consumer representatives all share a sincere desire to end the abuses. This must, however, be done in a way that does not reverse the tremendous strides that have been made to expand mortgage capital to all communities. Let me then address the steps MBA believes should be taken in order to bring a lasting solution to this problem.

Education of Consumers

First, as outlined above, educating consumers is most basic step in the struggle to push predators out of our neighborhoods. MBA continues to believe that the most effective weapon against abusive lending is a well educated consumer in a competitive marketplace.

⁷ For an excellent description of the unintended harms of the GFLA, see "*Georgia Fair Lending Act: Unintended Consequences*," Georgia Credit Union Affiliates, Community Bankers Association of Georgia, Georgia Bankers Association (January 2003).

To this end, MBA has created a consumer education program called “*Stop Mortgage Fraud*.” This consumer financial literacy program—available in English, Spanish, and, soon, in Arabic—is written in plain language, and attempts to provide useful guidance to consumers about how they can protect themselves in potentially abusive situations. The information provided by MBA’s program gives consumers three important tools they can use to help prevent them from being subject to “predatory lending” practices:

- a. Borrower’s Bill of Rights – which provides a detailed listing of consumer rights during the mortgage transaction from the first contact with a lender/broker to the closing of the loan.
- b. 10 Warning Signs of Predatory Lending – which lists the 10 common warning signs of predatory lending. These signs include everything from being asked to leave signature lines blank to being encouraged to include false information on a loan application.
- c. Where to Report Suspected Predatory Lending – consumers can either visit the www.stopmortgagefraud.com Website or call a specified toll-free number (1-800-348-3931) to get information on what steps to take to file a complaint. Consumers calling the 800 number will receive a brochure that contains information also found on the Website.

Enforcement of Existing Laws

MBA strongly believes that much more must be done to enforce the laws that are currently on the books. In the past quarter century, both federal and state governments have put in place a far-reaching body of laws designed to prevent abuse of consumers in credit transactions. As mentioned above, there are myriad laws that exist at the federal and state levels that could effectively address the abuses that are occurring in the market today.

MBA has been extremely proactive in the process of exploring the necessary steps to ensure that state and federal authorities are properly equipped to adequately enforce existing laws. In June 2003, MBA hosted an Enforcement Summit in Washington, DC,

that was attended by federal policymakers, consumer groups, key federal and state regulators, and real estate finance industry representatives. At the Summit, MBA discussed federal as well as state and local enforcement of consumer protection laws and reviewed a number of alternative approaches to combat abusive lending practices.

Summit participants identified the following as appropriate action steps toward further consumer protection:

- Increase resources for enforcement by exploring ways to generate new funds through a financial assessment program with generated funds being targeted at increasing effectiveness of enforcement, promoting anti-abusive lending practices and increasing the visibility of federal state and local regulators.
- Study and develop recommendations on establishing a National Resource Center and Clearinghouse for financial education, literacy and counseling.
- Explore innovative ways to reach consumers who may be vulnerable to potential abusive lending practices, including establishing a Financial Literacy Month.
- Commission a study on the practices of abusive lenders.

In the coming weeks, MBA will release a report summarizing the key discussions and findings of the Summit. For MBA, this Summit represents the beginning of meaningful communications with all groups interested in resolving problems and issues surrounding abusive mortgage lending.

In addition, MBA understands that enforcement efforts are not easy undertakings. They require time, careful examinations, documentation of disclosures, documentation of sales techniques, and interviews with parties involved, among other things. This approach, however, is one of the most effective ways to stamp out abusive lending practices. To this end, MBA calls for increased funding of consumer protection agencies to provide them all necessary resources so that we may more effectively clamp down on unscrupulous actors.

Mortgage Simplification

MBA has consistently argued that no regulatory approach will deliver true consumer protection unless underlying market defects are addressed through a comprehensive reform of the mortgage lending laws. The real key to achieving true long-term reform in the subprime market does not lie in limited efforts to drive out bad practices and bad actors from the market. Rather, the critical reform objective should be to attract reputable lenders into a marketplace of consumers that are able to make educated decisions with a wide variety of terms and options. A competitive market with informed consumers provides the best protection against predatory activity.

As mentioned above, predatory lending is in many ways a symptom of larger problems that have evolved from complicated and outdated mortgage laws. Without broad changes to existing laws and comprehensive reform of current cost disclosures, any efforts to address predatory lending will merely deal with the effects and not with the underlying causes of the problem. If the process remains confusing and perplexing, consumers will continue to be tricked and deceived.

Uniform Standard

A most important point that MBA wants to bring to the forefront, stemming from all the difficulties identified above, is that the only way to ensure the proper and efficient delivery of mortgage capital to our neediest populations is to develop a national solution to “predatory” lending. We therefore urge this Committee to support us in the push for an efficient marketplace through the establishment of a uniform national standard to combat abusive lending practices.

MBA believes that a single standard will encourage competition, and will ensure that the entire mortgage lending industry complies with one set of laws while allowing consumers to have a greater grasp of the lending process to keep them from falling prey to unscrupulous practices. We believe that we can, and must, craft strong safeguards that afford effective levels of protection for all of our citizens and that preserve the efficiencies of a unified legal structure.

As I noted before, such a uniform national standard for mortgage loans is the only realistic solution in an industry that operates and accesses capital from national, and indeed international, sources. MBA is not alone in this request. I note that every major player in the mortgage industry is appealing to bring order to the bewildering fragmentation of the mortgage market. In the past several months, the Office of Thrift Supervision (“OTS”) has acted to issue preemption orders with regard to local “predatory lending” laws in New York, New Jersey, Georgia, and New Mexico that restrict the activities of thrift institutions. We understand that the OTS is reviewing other state legislation as well. As we speak, the Office of the Comptroller of the Currency (“OCC”) is considering issuing regulations that would set forth a national preemption standard for national banks generally.⁸ Another important pronouncement has come from the Government-Sponsored Enterprises. Only a few weeks ago, in unison, both Fannie Mae and Freddie Mac declared their support for the creation of a national preemptive standard that resolves the mounting difficulties imposed by the current patchwork of local laws.

We ask this committee to listen to the urgent and combined calls for the development of national uniform standards to fight against “predatory lending.” Our most credit starved communities will be the principal losers if we fail to act.

VI. Conclusion

In summary, MBA believes that the search for solutions to the vexing problem of abusive mortgage lending must include comprehensive attention to all the underlying factors that allow predatory lending to flourish. We must address predatory lending through direct attacks on three fronts: a commitment to full enforcement, robust education, and a simplification of existing laws. As we do this, we must also come to agreement about the need for an efficient marketplace through the establishment of

⁸ See 68 Federal Register 46119 (August 5, 2003).

uniform national standards that assemble and focus our efforts in the fight against abusive lending practices.

Thank you for the opportunity to appear before the Committee. I look forward to answering all your questions.